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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

NO. 23

KARL F. KNETSCH, ET AL., *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

BRIEF OF AMICUS CURIAE

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> that the reason for denying the interest deduction in such cases no longer exists. Accordingly, your committee recommends the omission from the bill of the provision prohibiting the deduction of interest 'on indebtedness incurred, or continued, or the proceeds of which were used, in connection with the purchasing or carrying of an annuity.'"

Ever since the 1934 Act, interest on annuity loans has remained deductible. As discussed above, Congress, in enacting the 1954 Code, specifically considered the interest deductions in cases exactly like the present one and in section 264 disallowed the deduction only with respect to indebtedness incurred in connection with a single-premium annuity contract purchased after March 1, 1954.

Since Congress saw fit to allow an interest deduction in this case neither the Commissioner nor the courts should substitute their judgment for that of Congress. The duty of the Commissioner and the courts is to enforce the tax laws as enacted by Congress, not to mold tax policy in areas in which they disagree with Congress.

IV. Conclusion

This Court should reverse the judgment of the court below.

Respectfully submitted,

RICHARD H. APPERT,
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Amici Curiae

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BRIEF OF AMICUS CURIAE

I. *Interest of Amicus Curiae*

This brief is submitted, with the written consent of both sides, in support of the position of the Petitioners by Douglas W. McGregor, as *amicus curiae*. Douglas W. McGregor is attorney for the appellees in the case of *United States of America, Appellant v. Rufus C. Salley and Beulah S. Salley, Appellees*, No 18,482, in The United States Court of Appeals for the Fifth Circuit which is presently under a stay order pending a disposition of this particular case. The *Salley* case involves legal issues, in part, similar to those in the present case.

II. *Preliminary Statement*

Amicus curiae herein addresses this brief to the effect of the Texas law on the particular set of facts involving petitioners. Consent to file this *amicus curiae* brief was granted by the Solicitor General on condition that this particular brief be confined to the effect of the Texas law on the annuity contract.

III. *Summary of the Argument*

For a period of many years since the founding of the insurance business in the State of Texas, it has been legal under the statutes of the State of Texas regulating insurance companies to accept premium notes from policyholders of insurance companies for the amount of the premiums due on their policies and to make loans on the cash surrender value of their policies. Texas Jurisprudence Vol. 24B, Page 360, Para. 155. The type of annuity savings bond issued to petitioners in this case likewise have been authorized by the Insurance Laws of Texas for many years. Such savings bonds being "Exhibits 3-12". The issuance thereof and the executing of annuity loan notes and assignments secured by such bonds, which security loan notes and assignments are "Exhibits 13-22", also "Exhibits 26-35" and "Exhibits 38-47", were legal and of general force and effect in the State of Texas, authorized by statute under its Constitution at the time of issuance and execution of same. Such obligations when created by the State of Texas are valid and under its laws cannot be rendered invalid for purposes of taxation. The interest payable on the obligations as specified in the particular contract constituted a deduction under the Internal Revenue Act then in force and effect.

IV. *The Argument*

The annuity contracts in question here from the Sam Houston Life Insurance Company are designated on their face to be single premium thirty-year maturity annuity savings bonds with optional maturity date. The form of annuity contract "Exhibits 3-12" was duly filed with the Board of Insurance Commissioners of the State of Texas and was approved as it was determined its provisions met the requirements of the Insurance Code of the State of Texas. (See this brief's appendix P. 15).

The essential provisions of said contract do not differ from any other similar annuity contract issued by various other life insurance companies throughout the United States. Art. 3.44 of the Insurance Code of the State of Texas requires that all life insurance and annuity policies shall contain certain provisions, and the contracts in question here complied therewith.

Under Para. 6 of Section 3.44 of the Insurance Code it is provided;

> "After three (3) full years' premiums have been paid the company at any time while the policy is in force will advance upon proper assignment of the policy and upon the sole security *thereof* at a specified rate of interest a sum equal to, or at the option of the owner of the policy, less than the cash value of the policy and of any dividend additions thereto, . . ."

Further in that article and in the unnumbered paragraph following Paragraph 11, it is provided that;

> "Any foregoing provision, not applicable to single premium policies shall to that extent, not be incorporated therein."

This paragraph, of course, refers to the "three (3) years" provision as set out in the above quoted Paragraph 6. Since the contracts in question are single premium annuities the the three-year provision would not apply. This is further explained by the Board of Insurance Commissioners in Paragraph 7c (Appendix page 18) of the *Life Policy Form Manual* as follows:

> "7c. Loans must be made available at any time while the policy is in force after premiums for three full years have been paid. This does not prohibit loan values of $0.00 after three years premiums have been paid when the reserve less the allowable surrender charge does not result (in) a positive figure. *Since a single premium policy has premiums paid for all years when it is issued*, it must provide loan values for all years including the first."

And further subparagraphs (d) and (e) of said Manual provide. . .

> "(d) The loan clause must provide for proper assignment of the policy to the company."
>
> "(e) The policy *must be the sole security* for the loan."

The Government has emphasized the fact that the notes executed by taxpayer and secured by the assignment of the annuity contracts were *nonrecourse* notes and therefore lacked substance as valid obligations. However, it must be apparent from the provisions of the *Insurance Code of the State of Texas* (in the *Life Policy Form Manual* promulgated thereunder) that no other type of note could be accepted and that the anuity contract itself must be the "sole" security therefor. Similar provisions are in force

in every other State. The annuity contract likewise provides for the assignment of the contract as a sole security for this type of loan (Knetsch Exhibits 3-12).

> See *Border National Bank of Eagle Pass, Texas v. American National Bank of San Francisco, California*, 282 F. 73, (C.C. 5th, July 19, 1922) Opinion by Bryan, Circuit Judge, "/18/ It is required by the Negotiable Instruments Act of Texas (Vernon's Annotated Civil Statutes, Supplement 1922, Article 6001-3) that an instrument to be negotiable must contain an unconditional promise to pay. But the Act also provides (Article 6001-196) that in any case not therein provided for the rules of the law merchant shall govern. The Act only affects conditional promises insofar as to make them non-negotiable; it does not affect their validity."

Any insurance company, of course, must conform its contracts to the statutory laws of the State in which it operates, and it is statutory in Texas that the policy or annuity be the *sole* security for a loan. It is also statutory as above illustrated, that the note given to secure the loan must be a nonrecourse note.

It might be stated, parenthetically that the notes in question (Knetsch Exhibits 13-22, 26-35, and 38-47) are identical in substance with notes employed generally by insurance companies on loans against the loan or cash values of life and endowment policies, as well as annuity contracts, the interest payments on which certainly are deductible.

In addition, in order for the operation of an insurance company to be economically sound, it must invest the premium and interest payments in accordance with statutory laws, regulating its investments, at a given rate of interest

or return on funds invested which will be in excess of the rate of interest it agrees to pay policyholders and beneficiaries on the funds placed in the company's policyholders' reserve. One of the soundest investments of any life insurance company is to lend the policyholder money against his individual contract at a higher rate of interest than it agrees to pay him. No policyholder can lose under this arrangement, nor can the company. Among requirements pertaining to investments by life insurance companies doing business in the State of Texas is that they shall invest and keep invested in Texas securities and in Texas real estate a certain percentage of the aggregate amount of the legal reserve. (Art. 3.33, *Insurance Code.*)

Under Art. 3.34 of the Insurance Code *"Texas Securities"* are defined, among other investment, as -:

> "Loans made to policyholders on the sole *security* of the reserve value of their policies."

and, further in Art. 3.39 pertaining to and regulating investments for domestic companies, it is provided in Paragraph 2 of said article that:-

> ". . . It may also make loans upon the security of *or purchase of its own policies.*"

The "reserve value" as expressed in the *Insurance Code* and "the cash value" as expressed in the annuity contracts in question are identical.

The contracts and the notes involved herein comply with the above aspects of the *Texas Insurance Code.* Therefore, it is apparent that when Knetsch executed notes to the Sam Houston Life Insurance Company for the payment

of premiums on the annuity contracts the terms and provisions of which are essentially the same as most other insurance companies, the company acquired a valuable asset recognized as valuable by the *Board of Insurance Commissioners of Texas*, (See appendix P. 16-17) and taxpayers acquired a valuable contract containing a number of benefits of value to them and to their estate.

Under the terms of the contract each year for each $35.00 and interest annuitant pays the insurance company, it immediately invests $25.00 of this amount as required by the Insurance Code of Texas at interest in securities which qualify as legal reserve investments to build up and maintain the cash and loan values published in the annuities. The company simply pays a lower rate of interest than annuitant agrees to pay on the loan against the annuities. The basis of the annuities is stated in Paragraph 13 under the caption "General Provisions and Conditions." (Exhibit 3-12). It is submitted that the obligation created hereby was an enforceable obligation between the respective parties and that it had real substance because of the fruits to be gained by the purchaser, and the income to be received by the seller.

B. An obligation created in the State of Texas valid under its laws cannot be rendered invalid for purposes of income taxation by the simple expediency of arguing that the particular form of transaction has no commercial benefit or has no commercial value. The Government has argued in the past and in all probability will argue now that this is a transaction in form rather than a reality. When such an argument is made it runs head on into the laws of the State of Texas which authorize this type and form of investment and which has authorized it for many years.

This is not a new thing. For more than twenty years after the sanction against this form of interest deduction was taken out by the 1934 Amendment to the Internal Revenue Code. No question was raised by Statute or by the Commissioner as to the deductibility of such interest. Tacitly the Commissioner, and openly the Congress has approved it.

It has been stated in one of the briefs in the Courts below that the Government does not argue that the entire transaction is a sham. On the contrary, they admit that there is a valid agreement, for as the name states, an annuity and a savings bond, they do exist. They do, however, urge that the loan features of the agreement have no reality. It is strange that at this late date the Government says that such loan features have no reality when such features have been in the laws of the State of Texas (and other States) for many years, and the type of loan that is involved in this case and others of like nature have been permissible under the Insurance Laws of the State of Texas for some time.

As a matter of fact, Congress has recognized the existence of such loans by virtue of the inclusion of a provision against interest being deductible on them in the 1932 Act and a replacing of a prohibition against the deduction of interest in the 1954 Act. Certainly then, to that extent they have a reality. The reality lies in the Statutes of the State of Texas, and in business practice of many years standing, wherein such an obligation has been recognized and where it is not only perfected as to form, but has been recognized in substance over the years. Are we to say now that because taxation has reached such a high bracket that this form of investment will save some income taxes to a person with high income that this contract has no reality?

Before and since 1938 when *Erie v. Tompkins*, 304 U.S. 64, was decided, questions of State Law have been under consideration in Tax cases.

The consideration of State Law for Federal Income Tax purposes has always been an important consideration in determining the impact of taxation under the various Revenue Acts. State Law is not considered in determining liability for taxes under the same principle as *Erie v. Tompkins*. An excellent differentiation of such doctrine is found in 72 Harvard Law Review, Page 1351 as follows:

> "Whether or not a particular fact is to be established by means of state law is a matter of legislative intent. If the reference to state law in the statute is explicit, there is no problem, but in most instances the intent is not clearly manifested. Under these circumstances the court must ascertain Congress' intent. Once it has been decided that state law must be considered, there may be a problem as to which state's law is controlling. Although the Supreme Court has not definitely settled the point, it seems that, contrary to the rule in diversity cases, a federal conflict-of-laws doctrine should obtain. After the appropriate state's law has been chosen, the court in a tax controversy must determine the applicable substantive law, as it would under *Erie*."

Also cf. 55 Harvard Law Review 255:

> Whether a particular fact is to be established by means of state law is a matter of Legislative intent."

Burnet v. Harmel, 287 U.S., 103, which states as follows:

> "State Law may control only when the operation of the Federal Taxing Act, by express language or

necessary implication, makes its own operation dependent upon State Law."

On April 19, 1909 Senate Bill No. 291 of the Texas Legislature, Gammel's Laws of Texas, Page 192 became law. This was an Act to authorize the incorporation of life, accident and health insurance companies, and defining the same. In Section 10(b) the Legislature provided:

> "It may also make loans upon the security of or purchase (of) its own policies but no loans on any policy shall exceed the reserve value thereof."

And, in Section 22-6. It provided for making loans after three full years premiums had been paid but provided that this provision did not apply to term insurance with other provisions similar to those presently in existence in the Insurance Code of Texas.

See also Revised Civil Statutes of the State of Texas, 39th Legislature 1925 Vol. II, Page 1298 Art. 4725-2.

> ". . . It may also make loans upon the security of or purchase of its own policies . . .". To the same effect Vernon's 1936 codification of Texas Civil Statutes.

In addition to the foregoing legal history of the Insurance Code of Texas, it is worthy of note that business practice has grown up around the statutes and they have been utilized in the sale of various kinds of insurance. To illustrate to the Court that the loans involved here constitute sound business practice under the Statutes of the State, attached hereto and made a part hereof in the Appendix is an Examiner's Report of the Sam Houston Life Insurance Company. (See Appendix Page 19).

It would, therefore, appear that the provisions in question here on the type note involved have been in effect in Texas since 1909, and it is asserted that presently such provisions are in effect in all of the States of the Union. It is implicit in the action of Congress by taking out the interdiction of the interest deduction in the 1934 Code and the replacing of same in the 1954 Code, that Congress was aware of this type loan and this type interest payment.

The *necessary implication* found in the Tax Law, in reference to this deduction, that same causes or makes its operation dependent upon State Law is clearly disclosed by the Legislative History of the interest deduction in Congress. When the Revenue Act of 1924 was being enacted the House version restricted the interest deduction to interest paid or incurred in carrying on a trade or business and other interest paid or incurred which, when added to non-business losses exceeded tax-exempt interest received. However, prior to enactment, the trade or business requirement was eliminated and a deduction was allowed for all interest on indebtedness incurred or continued to purchase or carry tax-exempt securities. Again, when the Revenue Act of 1926 was pending, the House attempted to restrict the interest deduction to interest paid or incurred in business and the excess of other interest paid in excess of tax-exempt interest received, but the Senate reinserted the 1924 provision. There has never been any other attempt to limit the interest deduction to interest paid or incurred for a business purpose.

In the treatment of annuity loans, the 1932 Act provided that interest paid for borrowed money to purchase

annuities was not deductible but the reason for that was that annuities under such Act were not taxable. The Legislative History of the Revenue Act of 1934 is very persuasive. Mr. Doughton of North Carolina from the Committee on Ways and Means, filed its report which became House of Representatives Report No. 704, 73rd Congress, 2d Session, February 12, 1934 and under 23(b) under such report made the following statement:

> "A similar course has been adopted in the case of indebtedness *incurred* or continued to purchase an annuity. If the proceeds of the indebtedness are actually used in purchasing or *carrying* the annuity, no deduction is permitted for the interest incurred on such indebtedness."

Subsequently thereto, Mr. Harrison from the Committee on Finance filed Senate Report No. 558, 73rd Congress, 2d Session Calendar #591, March 28, 1934 as to Section 23(b) of such Act, stated as follows:

> "The existing law also prohibits the deduction with respect to interest paid or *accrued* on indebtedness *incurred* or continued to purchase or *carry* an annuity. The House Bill enlarges this prohibition to apply if the proceeds of the indebtedness are actually used in purchasing or carrying an annuity. The theory for not allowing the deduction in such cases is that, since the annuitant was not required to report annuity payments as income (until they exceeded his capital investment), he ought not to be permitted to reduce his taxable income by the allowance of such a deduction. However, since the annuitant is required under the bill to include in income a certain part of the annuity payment received each year, your committee is of the opinion that the

reason for denying the interest deduction in such cases no longer exists. Accordingly, your committee recommends the omission from the bill of the provision prohibiting the deduction of interest on indebtedness incurred, or continued, or the proceeds of which were used, in connection with the purchasing or carrying of an annuity.'"

Subsequently thereto Mr. Doughton on April 30, 1934 from the Committee of Conference acting on Revenue Bill of 1934 reported as follows as to 23(b):

"Amendment No. 18: Under existing law a taxpayer is denied a deduction for interest paid or accrued on money borrowed to purchase an annuity. The House Bill also denies the deduction if the money borrowed was actually used to purchase an annuity even though the indebtedness was not incurred for that purpose. *The Senate amendment permits a deduction in both of such cases; and the House recedes.*"

It would, therefore, appear that by *necessary implication* Congress recognized State laws creating the type obligation here involved and that *Erie v. Tompkins* comes into play. Furthermore, it would seem presumptuous to even concede the right to question the deduction of the interest in the instant case, as it is patent that Congress had thoroughly considered the matter on previous occasions and removed its interdiction on such deduction. Here the remedy lies with the Legislature as sought under the 1954 Code and not through the Court.

"Courts have sometimes exercised a high decree of ingenuity in the effort to find justification for wrenching from the words of a statute a meaning which literally they did not bear in order to escape

consequences thought to be absurd or to entail great hardship. But an application of the principle so nearly approaches the boundary between the exercise of the judicial power and that of the legislative power as to call rather for great caution and circumspection in order to avoid usurpation of the latter. *Monson v. Chester*, 22 Pick. 385, 387. It is not enough merely that hard and objectionable or absurd consequences, which probably were not within the contemplation of the framers, are produced by an act of legislation. Laws enacted with good intention, when put to the test, frequently, and to the surprise of the law maker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law making authority, and not with the courts.", *Noah Crooks, Collector of Internal Revenue, Petitioner, vs. Benjamin Harrelson, et al*, 282 U.S. 55 63.

Conclusion

This Court should reverse the Judgment of the Court below.

Respectfully submitted,

Douglas W. McGregor

DOUGLAS W. McGREGOR,
Amicus Curiae

McGREGOR, SEWELL & JUNELL
Of Counsel:

Copies of this Brief have been served on the Parties at interest.

Douglas W. McGregor

Douglas W. McGregor

APPENDIX

Insurance Code, Acts 1951, 52nd Leg. Ch. 491, (Vernon's Annotated Texas Statutes, Vol. 14.)

Art. 3.01. Terms Defined

A life insurance company shall be deemed to be a corporation doing business under any charter involving the payment of money or other thing of value, conditioned on the continuance or cessation of human life, or involving an insurance, guaranty, contract or pledge for the payment of endowments or annuities.

* * *

Art. 3.33 Required Investment in Texas Securities

Each life insurance company now engaged, or that may hereafter engage in transacting the business of life insurance in this State, shall, as a condition of its right to transact such business in this State, invest and keep invested in Texas Securities and in Texas real estate, as hereinafter provided, a sum of money equal to at least seventy-five (75%) per cent of the aggregate amount of the legal reserve required by the laws of the state of its domicile, to be maintained on account of its policies of insurance in force written upon the lives of the citizens of this State, which reserve is hereafter denominated as its "Texas Reserves." And each such company, securing a certificate of authority to do business in this State, shall be deemed to have accepted such certificate subject to all the conditions and requirements of this chapter. Art. 3.34. Texas Securities

The term "Texas Securities", as used in this chapter, shall be held to include * * * and loans made to policy holders on the sole security of the reserve values of their policies. * * *

* * *

Art. 3.39. Authorized Investments for "Domestic Companies

A life insurance company organized under the laws of this State may invest in or loan upon the following securities, and none other, viz: * * *

2. It may loan any of its funds and accumulations, taking as security therefor such collateral as under the previous subdivision it may invest in. * * * It may also make loans upon the security of or purchase of its own policies. No loan on any policy shall exceed the reserve values thereof. No investment or loan, except policy loans, shall be made by any such insurance company, unless the same shall first have been authorized by the Board of Directors or by a committee charged with the duty of supervising such investments or loans. * * *

* * *

Art. 3.44 Policies Shall Contain Certain Provisions

No policy of life insurance shall be issued or delivered in this State, or be issued by a life insurance company organized under the laws of this State, unless the same shall contain provisions substantially as follows: * * *

6. That after three (3) full years' premiums have been paid. the company, at any time while the policy is in force, will advance upon proper assignment of the policy and upon the sole security thereof at a specified rate of interest a sum equal to, or at the option of the owner of the policy less than, the cash value of the policy and of any dividend additions thereto; and that the company may deduct from such loan value any existing indebtedness on the policy and any unpaid balance of the premiums for the current policy year, and may collect interest in advance on the loan to the end of the current policy year, which

provision may also provide that such loans may be deferred for not exceeding six (6) months after the application therefor is made. It shall also be stipulated in the policy that failure to repay any such advance, or to pay interest shall not void the policy until the total indebtedness thereon to the company shall equal or exceed the cash value. No condition other than as herein provided shall be exacted as a prerequisite to any such advance. This provision shall not be required in term insurance, nor in pure endowments issued or granted as original policies, or in exchange for lapsed or surrendered policies.

* * *

11. A table showing the amounts of installments in which the policy may provide its proceeds may be payable.

Any foregoing provision, not applicable to single premium policies shall, to that extent, not be incorporated therein.

* * *

Life Policy Form Manual (Adopted by Board of Insurance Commissioners of the State of Texas, November 16, 1944)

Section I. Required Provisions

* * *

7. Policy Loans.—(Ordinary only; not applicable to Industrial, although industrial policies may contain a loan clause.)

a. A policy loan provision is not required in term insurance policies nor in pure endowments issued or granted as original policies or in exchange for lapsed or surrendered policies. If, however, the term insurance policy or pure endowment provides for loan values, a table of such values must be shown in the policy.

b. The policy must contain no provision denying loan values in connection with paid-up life or endowment insurance granted as non-forfeiture benefits under the policy.

c. Loans must be made available at any time while the policy is in force after premiums for three full years have been paid. This does not prohibit loan values of $0.00 after three years premiums have been paid when the reserve less the allowable surrender charge does not result is a positive figure. Since a single premium policy has premiums paid for all years when it is issued, it must provide loan values for all years including the first.

d. The loan clause must provide for proper assignment of the policy to the company.

e. The policy must be the sole security for the loan.

f. The rate of interest must be specified and may be payable either in advance or at the end of the policy year.

g. The loan clause must provide for lending the insured a sum equal to, or at the option of the owner of the policy less than, the legal reserve at the end of the current policy year on the policy and on any dividend addition thereto, less a sum not more than 2½% of the amount insured by the policy, and of any dividend additions thereto. Note that the loan value at any time must be defined as the reserve at the end of the current policy year less the allowable surrender charge.

h. The policy may provide that the company may deduct from such loan value any existing indebtedness on the policy and any unpaid balance of the premium for the current policy

year, and may collect interest in advance on the loan to the end of the current policy year.

i. The policy may provide that loans may be deferred for not more than six months after application therefor is made.

j. The loan clause must provide that failure to repay any such advance, or to pay interest thereon, shall not void the policy until the total indebtedness thereon to the company shall equal or exceed the loan value. The policy may not be terminated merely for failure to pay loan interest when due.

k. No condition other than as herein provided shall be exacted as a prerequisite to any such advance.

Excerpts from Examination Report of the State of Texas Board of Insurance Commissioners

Being excerpts as marked from Examination Report of the State of Texas Board of Insurance Commissioners as of December 31, 1953 of Sam Houston Life Insurance Company, Houston, Texas.

Policy Loans—$20,707,986.80

The above asset is comprised of 54 loans made to policyholders secured by the Company's annuity and life contracts. Forty-two of the loans, in the amount of $20,702,720.00, are on one year payment, twenty and thirty year maturity annuity bonds. The remaining twelve loans are on small annuity contracts and life policies with an accumulated cash value. The one payment contracts carry a first year interest rate ranging from 3½ per cent to 6 per cent; renewal interest ranging from 3 to 6 per cent. The contracts are issued by the Company on the basis of allowing the applicant to secure a full loan against the first year

cash value. When the loan is made the applicant signs an interest bearing note which is paid in advance.

Interest received on the loans for the year 1953 was verified. Interest due was determined to be $1,498.50 and has been allowed as a non-ledger asset in the balance sheet. The due interest was paid in January, 1954, subsequent to the examination date. Unearned interest was computed in the amount of $536,777.34 and has been shown as a liability in the balance sheet.

LIABILITIES

Aggregate Reserve for Life Policies and Contracts—$21,589,234.73

Company group valuation tabulations indicated the following amounts of insurance in force and the reserves thereon as of December 31, 1953:

Description	*Amount of Insurance*	*Reserves*
American Experience 3½%:		
Full preliminary term	$ 53,518.00	$ 6,979.41
Yearly renewable term	432,442.00	1,998.00
Net level	59,500.00	721.00
Commissioners Std. Ordinary 3%:		
Full preliminary term	7,774,044.00	64,531.00
Yearly renewal term	432,442.00	1,998.00
Net level	649,500.00	2,560.00
Commissioners Std. Ordinary 2¾%:		
Full preliminary term	3,894.00	195.23
Total insurance and reserves	9,131,898.00	78,087.64
Less reinsurance	2,452,561.00	9,077.10
Net insurance and reserves	6,679,337.00	69,010.54

Other reserves:

Annuities	20,823,293.13
Supplementary contracts with life contingencies	1,559.00
Accidental death benefits (less $403.00 reinsurance)	3,569.00
Disability—active lives (less $265.00 reinsurance)	261.00
Reserve for coupon accumulations	686,238.79
Reserve for guaranteed annual returns	3,542.27
Extra premium reserve	1,761.00
Aggregate reserve for life policies and contracts	$21,589,234.73

The above amounts of life insurance and corresponding reserves were established from detailed tabulations of individual machine punched reserve valuation cards. The cards were sorted and tabulated in group valuation order, and proper mean reserve factors per thousand dollars of insurance were applied to the group totals to produce the total reserves indicated in the foregoing schedule.

The reserve valuation method employed for each plan of insurance was verified against specific policy provisions, and a large number of mean reserve factors were test checked against appropriate actuarial tables. The mechanical extensions were tested, the Company summaries were checked in detail, and the summary totals were traced to the aggregate liability.

Reinsurance reserve credits were established on a yearly-renewable, attained age basis, and were computed upon the basis of the Commissioner 1941 Standard Ordinary Mortality Table with interest at 3 per cent. Tests indicated that the reinsurance tabulations were complete and accurately computed.

The Company's file of specimen policy forms was inspected. The specimen form of each life insurance and annuity contract issued by the Company bore the file stamp of the Texas Board of Insurance Commissioners.

Of the $20,823,293.13 reserve for deferred annuity contracts, as shown in the foregoing schedule, $20,728,252.13 is the reserve established by the Company for 105 individual single premium annuity contracts deferred for 15, 20, or 30 years. In view of the large amounts of reserves for single premium annuity contracts, the reserve was computed for each contract separately in accordance with methods filed with the Board of Insurance Commissioners. For each contract, the December 31, 1953, reserve was established by interpolating to the exact day between the 1953 and 1954 terminal reserves. The computations for each contract were checked in detail, and the method of valuation verified against specific policy provisions. The completeness of the valuation was verified by checking the listings against the Company's register for these contracts. No differences were noted, and it appears that the Company's valuation of the reserve liability on these contracts was complete and accurate.